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Monthly Letter on Economic Conditions Government Finance

New York, October, 1953

General Business Conditions

THE end of the vacation season is usually a time of close scanning of the business figures and inquiry into the outlook, and this year is no exception. There is much talk of a period of adjustment, and people are trying to make up their minds about it. Production and trade during the spring were the highest in the country's history. The summer, while showing expected seasonal slackening, and in some lines a little more, was nevertheless the busiest summer on record. For some time, however, predictions of a downtrend in the closing months of the year have been made. Forecasters have pointed out, among other things, that part of the demand which in the spring raised steel mill operations above their rated capacity was for the purpose of rebuilding inventory; that the rise in consumer credit might signify a borrowing from the future in automobile and other consumers' durable goods sales, which have given such strong support to business; and that plant and equipment expenditures, although greater than anticipated, were probably passing their peak. In these areas particularly some drop in demand has logically been expected.

Inventory figures running through the second quarter show that production in the aggregate was then exceeding consumption. A declining trend, though by no means severe, appeared earlier in manufacturers' unfilled orders. These trends raised questions as to how long the record production rate could be supported. Sentiment has also been affected by economic and political developments. The Korean truce, indications of reduced government spending and tighter money, the drop in farm product prices and buying power, and a general feeling that the boom had run about as long as it could, all contributed to the expectation that the spring months would stand as the year's peak. The stock market has reflected this feeling, and price declines in some industrial raw materials indicate that it is present in the industries.

The Test of Predictions

The fall season is the time when these predictions will be tested. The principal question is how far a slackening in durable goods lines may go and whether it will have pronounced effects on general employment and trade. Reports during September make it clear that adjustments are under way in some areas, although in many others activity is unimpaired, the position strong, and sentiment good. Steel ingot production has dropped from a peak of 2,324,000 tons a week last spring to an average of about 2,075,000 in September, and scrap steel prices are weak. Some curtailment of petroleum production and refining is in effect. The output of automobiles and other consumers' durable goods shows some falling off, and nonferrous metals prices have declined. Farm equipment business has slackened. Lay-offs due to cancellations or stretchouts of defense contracts are reported in some places, with more to come.

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On the other hand, the overall economic situation is plainly strong. The country has never had as many people at work and never, in peacetime, so few unemployed who are seeking work. Both at retail and wholesale, trade has picked up during September after lagging somewhat during the hot weather. Apparel sales have strengthened, and the service industries, including travel and recreation, have had a big summer. Sentiment in the mercantile trades, to judge by the large numbers of buyers in the wholesale markets and the commitments they are making, seems normally confident, though not speculative. Residential construction activity has not held its spring levels, but other construction, especially commercial building, stays at its peak. Money is not as tight as many expected it to be, and fears that even sound and desirable business capital expenditures might be blocked by money shortage are no longer acute.

"Rolling Readjustments"

Business has gone through readjustments since the end of the war, none of which, in retrospect, seems severe in terms of employment or trade. Fortunately, periods of curtailment and inventory liquidation in various industries have not run concurrently except in the spring of 1949. Textiles experienced a general recession in 1951-52. Other consumers' nondurables have been through corrective periods, during which, however, overall business was supported by defense work and high activity in most durable goods. Now the turn for a moderate decline in many of the durables seems to have arrived. The phrase "rolling readjustments" has been coined to describe these past movements, and the hope of the optimists is that it will prove to be as apt in the situation now developing.

If what lies ahead is another "rolling readjustment" the effect on overall figures will be moderate. Encouraging this hope is the strength of influences supporting demand. Government purchases of goods and services will be less than was estimated last January, but the drop as compared with actual outlays in fiscal 1953 will be small, and will require little adjustment in the economy. Moreover, while the Government will pump out less money it will also take a smaller cut of income in taxes.

In his speech to the American Bankers Association September 22, Secretary of the Treasury Humphrey summed up this prospect:

> Government spending now appears to be on the road to reduction. That is what the American people want and demand. But in spite of all we can do and all the savings we can make, a relatively small reduction is the most that we can hope to accomplish — quickly.
>
> That means that there will still be a tremendous amount of money to be pumped into the economy. And furthermore, it is the definite policy of this Administration through tax reductions, to return to the people for them to spend for themselves all the real savings in Government spending which can be reasonably anticipated.

By all signs, declines in plant and equipment expenditures will be moderate. There are important sustaining influences in residential building, including increasing size of families, continued shifting of population, and the development of a replacement demand for better homes. Finally, changes in the money markets during the summer, as described in the following article, indicate that while the monetary authorities have been concerned to put the brakes on inflationary expansion, they are equally concerned to avoid enforcing deflation.

What "Readjustment" Should Mean

Some forecasters — seeing a "gap" in demand created by minus signs in the durable goods industries — boldly say that consumers will spend more on nondurable goods and services in 1954 and thus maintain the level of business. They point correctly to high savings and to the record-breaking volume of cash and assets readily convertible into cash, such as Savings Bonds, which individuals hold. On the other hand, it is equally arguable that anticipation of even moderate declines in durable goods, affecting employment and income, will induce cuts in spending. Forecasts that the gap will be filled as described therefore rest on uncertain ground.

Such analysis, however, serves a useful purpose. If maintenance of full employment, production and trade is dependent on consumer demand, the responsibility of industrial management and labor becomes clear. If the needs of American families are to keep the factories busy, manufacturers must give them what they want at prices which they will be able and willing to pay. The requirement is for new things, attractive designs, efficient production and labor effort to cut costs and prices, and effective selling.

This is what "readjustment" should mean. The country has gone through a long period of record-breaking capital expenditures and enlargement of productive capacity. While the most basic of economic truths is that human wants are never fully satisfied, specific markets nevertheless become at least temporarily saturated and readjustment is required. Part of the needed adjustment is a shift of product, to things that will sell. Part is a stiffening of competition, putting pressure on higher cost facilities and leading to retirement of obsolete productive equipment.

The possibility of such adjustments should not inspire dread, but the contrary. The immense historical progress which mankind has made in its standard of living can be ascribed in last analysis to finding ways to produce and distribute better and more cheaply. This is the inevitable effect of new capital investment, and of the competitive forces which constantly work to reward the most efficient producers. A readjustment of this kind, lowering cost and improving efficiency, will pave the way for a more marked rise in living standards. The greater the success of cost-cutting efforts, the stronger the hope that 1954 will bring no more than minor recession.

In the speech previously mentioned, Secretary Humphrey said:

> High volume but good supply — that means competition, efficiency and more value for the consumer's dollar. Surely we have not deteriorated in this country so that all we can see is calamity if the day of allocations and the order-taker is passing and we again have to develop a salesman.

Undoubtedly the kind of salesmanship which Secretary Humphrey has in mind is finding out what customers need and want, and then giving it to them with efficiency, reasonable cost, and good service.

Intangible elements such as these should impress upon all that the course of business is not foreordained. It is easy to assume that there will be a gap in demand in some areas in 1954 as compared with 1953. However, similar gaps indicated in the past, notably just after the war, were filled in ways the pessimists never foresaw.

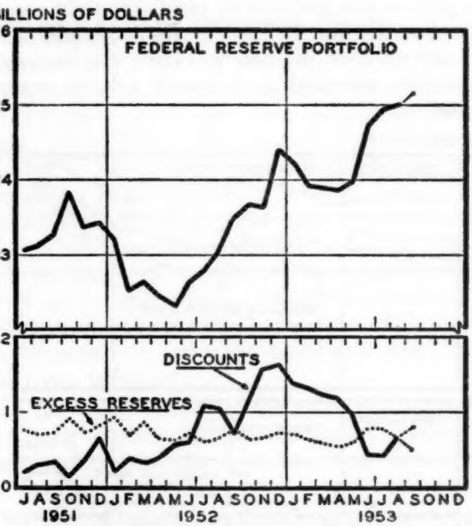
Credit Policy Eased Further

Symptoms of weakening in the boom, referred to earlier, and the failure of bank loan expansion to make a normal rise, led the Federal Reserve authorities in September to pump excess funds into the money market, through purchases of government securities, and thus to encourage banks to lend more freely. This was the third move the authorities have undertaken over five months to enlarge the supply of loan funds.

The first easing step, begun in a small way in May but mainly concentrated in June, was the purchase of $1.1 billion government securities in the open market. These operations, which put Federal Reserve holdings of government securities up to $25 billion for the first time in history, built up bank excess reserves, produced a sharp decline in borrowings from the Federal Reserve, and relieved fears that there were not going to be enough loan funds to take care of seasonal requirements of the Treasury and business during the second half of the year.

The second step, announced June 25, effective July 1-9, was a $1.1 billion reduction in member bank cash reserve requirements. This relief was sufficient to maintain the money market in a position of ease in the face of the Treasury's sale on July 15 of $5.9 billion nine months' certificates of indebtedness in anticipation of next March's income tax collections.

During August, surplus bank funds were drawn down by gold outflow and increased loan demands; Federal Reserve purchases of government securities were small. In September, however, the authorities continued their purchases of government securities to the point of forcing money into a market already comfortably supplied. As the chart shows, excess reserves were pushed up to a daily average of $750 million while average borrowings from the Federal Reserve fell below $500 million. The view now prevalent is that the authorities in the weeks ahead will release additional funds in the market, by further open market operations or reserve requirement reduction, thus limiting needs of banks to borrow up to the peak of seasonal pressure at the year-end.



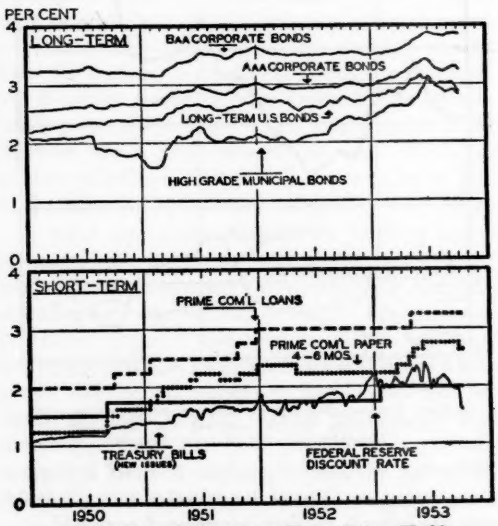
Federal Reserve Holdings of Government Securities and Member Bank Excess Reserves and Discounts (Monthly averages of daily figures)

The lag in loan expansion is most apparent in the category of bank loans to business, mainly very short-term credits. A normal seasonal rise would put business loans of the weekly reporting member banks up around $2 billion during the second half of 1953. Of this amount $1 billion could be expected to come during the July-September quarter. The actual rise experienced from July 1 to September 23 amounted to $450 million.

Consumer loans are expanding less rapidly than during the spring, although at that time many people were expressing concern over the speed of the rise. As a response to the easier money market since June, banks have bought State and local government obligations more actively and have considerably enlarged their holdings of U.S. government obligations. The supply of mortgage money has improved and present indications are that the rise in total mortgage indebtedness this year will exceed the $8.8 billion increase recorded in 1952.

Money Rates and Security Yields

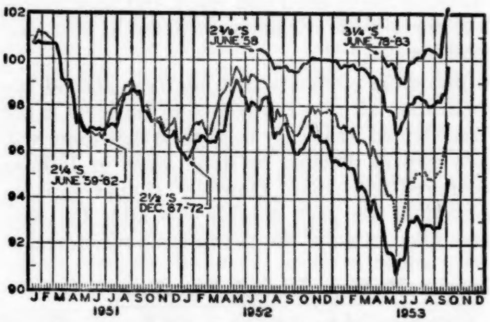
Bank loans are as high as they ever have been at this time of the year and additional seasonal expansion in loans, together with seasonal drain of cash from the banks, lie directly ahead. For these reasons customer loan rates have failed to show any reaction although there is no question but that loans are being extended more freely under the established rate structure. Open market money rates have generally softened; on September 29 the offered rate on prime 4-6 months' commercial paper eased off from 2¾ to 2⅝ per cent. Government securities have risen in price – and declined in yield – straight across the board. The feature of the corporate and municipal bond markets has been the favorable reception accorded an increased volume of new flotations.



Bond Yields and Short-Term Money Rates, Weekly

The Federal Reserve's latest purchases of Treasury bills, which raised the total bought since August 12 to $271 million, were mainly concentrated around the middle of September when the discount rate reductions in London and Paris were stirring rumors of similar action, or a reduction in bank reserve requirements, in the United States. Under the double influence of the Federal Reserve's purchases and anticipations of further easing actions, average yields on new issues of 91-day Treasury bills fell from a level barely below 2 per cent in the first half of September to 1⅝ per cent in the second half.

Yields on other classes of government securities also shrank during September, particularly shorter-term obligations. The new 2⅝ per cent certificates and 2⅞ per cent notes, put out by the Treasury September 15 in exchange for maturing 2 per cent bonds, reached premiums of 9/16 point and 1½ points respectively. Thus the yield to the buyer was cut to 2 per cent on the certificates and to 2⅜ per cent on the notes. Nine year 2¼ per cent bonds, which had gone as low as 92 early in June, rose to 97⅜. The Victory Loan 2½s due December 1972, which traded four months ago at 89⅞, reached 95. The thirty-year 3¼s issued May 1, which touched 98½ early in June and stood at 100½ a month ago, rose as high as 102½.



Friday Closing Bid Prices, Selected U.S. Government Bonds
(Last plotting for Wednesday, September 30)

The rapid decline in yields on Treasury bills – to the lowest levels since early 1952 – stimulated switching by corporate investors into Series B Treasury Savings notes, which are nonmarketable obligations redeemable in payment of taxes or in cash after four months' holding. The "B" notes were withdrawn from sale September 26 and supplanted effective October 1 by new Series C Savings notes offering lower rates of interest. Of all the various series of Savings notes that have been on sale since 1942 the Series B, introduced May 15 last and adjusted to the tight money conditions then prevalent, has had the shortest life. The predecessor "A" series was on sale for two years, paying 1.44 per cent for four months' holding up to 1.88 per cent for a term of three years. The "B" series, on sale May 15 to September 25, paid 2.16 per cent

for four months' holding up to 2.47 per cent for a term of two years. New Series C Savings notes put on sale October 1 pay 1.56 per cent for six months graduated upwards to 2.21 per cent for two years. They are usable in payment of taxes after two months' holding and redeemable for cash after four months.

Developing Receptivity to Funding

The accelerated sale of "B" notes, strengthening the cash position, reduced the need of the Treasury — and also its ability within the debt limit — to make further offerings of regular marketable securities for cash subscription. This fact, as well as the progress the Administration is making to hold down expenditures, has helped the tone of the market. There is little doubt but that the most receptive conditions in a year are developing for steps to improve the structure of the debt — pushing maturities out into the future and cutting down the frequency and amounts of early maturities.

Speeches by Secretary of the Treasury George Humphrey, and his deputy, Mr. W. Randolph Burgess, before the American Bankers Association convention two weeks ago, should dispel any thoughts that the Administration might have given up on its policy of improving the structure of the public debt. Secretary Humphrey set out debt management, along with a balanced budget and a flexible Federal Reserve policy, as the three pillars of sound money. He stated:

> . . . As of the moment our debt is more than $273 billion — which is a terrific amount of debt. The manner in which this debt is handled — that is, maturing issues refinanced and new issues placed — has a very substantial bearing upon the well-being of our nation's economy.
>
> Nearly three-quarters of this debt matures within less than five years or is redeemable at the holder's option. One of the things we are trying to do is to extend that average maturity gradually.
>
> We took a first step in this direction back in April by putting out a 30-year bond at 3¼ percent. That rate was higher than the rate for previous issues, but it reflected the going rate at the time of the issue as determined by the daily current market purchases and sales of outstanding government securities. Earlier this month we had an encouraging response to a proposal which allowed a choice between one and 3½-year maturities in refinancing an issue of $7.9 billion. About $3 billion of the total exchanged was voluntarily placed in the longer term security.
>
> It is our firm intention to offer more intermediate and long-term issues at opportune times in the future. We will use care, of course, not to press the market in competition with state, municipal and private financing which is at a peak of demand at the present time.

Mr. Burgess pointed out that the steps so far taken in funding the debt hardly show in the figures. "With this huge debt, getting shorter day by day, you have to run fast to keep even." Nevertheless, he took an optimistic view:

> There is every reason to look forward with confidence to this country's ability to put its financial house in better order without any serious disruption of credit or markets. The stream of the Nation's savings is huge — larger than ever before; the credit base is secure; the banking system is sound. With a reasonable assurance of sound, honest money of stable buying power there is no better investment than securities of the United States Government. The banks, insurance companies, and other financial institutions, businesses, and individuals have shown both their capacity and desire to cooperate with their Government in this effort.
>
> The speed with which the National debt can be redistributed will have to depend on the rate of the flow of savings; the pressure of demand for funds from other sources; and the state of the money market. You can't force free markets, and the Treasury has no intention of doing so. It took a long time, a huge war, and a huge defense program to get us where we are. It will take time to re-adjust.
>
> In this process we shall always have as our objective, sound money and economic stability, avoiding either inflation or deflation, and encouraging and not impairing the steady, forward growth of the country's activity.
>
> It is our belief that a sound debt policy will itself make for greater confidence, stimulate enterprise, and contribute to the well-being of all the people.

Cuts in Foreign Discount Rates

Action by the Bank of England and the Bank of France last month in cutting their rates of discount from 4 to 3½ per cent, coinciding with some easing in our own money markets, contributed to the already growing psychology of bearishness here regarding interest rates. In both cases the action came as a surprise, not only in this country but also in the London and Paris markets, which were not immediately prepared to evaluate them. Official explanations, and the policies maintained as to rates other than the discount rate, left some doubt as to just how much was intended.

In the week following the Bank of England and Bank of France action the Danish National Bank reduced its discount rate from 5 to 4½ per cent.

In London, official emphasis was placed upon the technical aspects of the adjustment, in that the regular Bank rate — which applies to discounts of approved commercial bills of exchange — was being brought into line with the 3½ per cent "Special" rate at which the Bank has been making 7-day loans to the market against Treasury bills. The latter rate, which in actual practice has been the rate at which the market has borrowed from the Bank, remains unchanged. In the "unification" of the two rates, the object, it was stated, was "to allow more freedom in

the day-to-day operation of the market," and "to facilitate the flexible use of Bank rate in either direction as circumstances may require."

The Bank's spokesman was at pains to deny that the adjustment meant any basic change in the tighter money policy pursued over the past eighteen months. All earlier instructions to the banks to curb lending for non-essential purposes still hold good. "Although our position is better," the statement said, "than when money rates were raised steeply in November 1951 and March 1952, these adjustments do not in any way imply that we are out of rough water or can in any way relax our efforts."

One intention, however, which the Bank noted, was to bring about some cheapening of facilities for financing foreign trade.

Conceding that "the recent slightly easier tendency in sterling exchange might be held to argue against a move at the present time," the Bank nevertheless held that "considering the normal seasonal demand for dollars in September, this tendency has not been at all strong."

In a similar way, the French action in reducing the Bank rate is regarded in Paris as a limited adjustment rather than a major change in monetary policy. The reduction is understood to be designed to lower financial charges for commercial business at a time when the increase in wages for the lowest paid workers is bound to be reflected in cost rises. The rate at which commercial banks discount their customers' trade acceptances has been lowered, but that for overdrafts remains unchanged. Despite its lower discount rate applying to prime bank bills, the Bank of France has maintained its former rates on advances, while the Treasury has not changed the rate at which it offers Treasury bonds. Likewise, the policy of setting discount limits for the commercial banks at the central bank remains in force.

A Gesture of Confidence

Despite the emphasis placed in London on the technical aspects of the Bank rate reduction, it seems that the move can hardly be swept aside as inconsequential.

In the first place, as pointed out by various commentators, the desired unification of Bank of England rates could have been achieved either by lowering the discount rate or by raising the Special rate. That the former course was chosen must signify to some extent increased confidence in the country's financial and economic position.

The decline in the rate comes at a time when the current softening in sterling exchange, after a period of sustained strength, is attributed largely to seasonal influences. It follows a steady, albeit modest, improvement in the gold and dollar resources. Despite an increase in total bank credit due to the financing needs of the Government, the volume of bank advances to the private sector of the economy has declined, and as of the latest report in August was at the lowest level since November 1950. In their overall weighing of the economic trends, the authorities apparently have become convinced of the appropriateness of making some initial step towards cheaper money, though still regarding conditions as far from justifying any return to an easy lending regime.

The basis for the rate action in Paris appears a good deal less firm than that in London. It is true that general production and trade in France are showing more slack than in England. On the other hand, the position of the franc in the international exchanges is weaker than that of the pound. The problem of inflation in France is more acute. Comments in the French market have indicated some apprehension lest the cheapening of money rates lead to additional pressure on the franc by encouraging importers to increase their long-term purchases of foreign currencies, and exporters to leave abroad foreign currencies earned from export sales.

Towards Money Market Normality

A second significant feature of the British Bank rate change has been the bringing about of a general realignment and reduction of open market money rates.

In the British market commercial bank lending rates are traditionally related to the Bank rate proper. Hence the existence of the Bank's lower Special rate on Treasury bills (referred to above) has had the effect of producing a wide spread between rates charged by the commercial banks on loans to their customers and those charged to the Government on Treasury bills. This discrepancy was also apparent in the margin between the market rate for bankers' acceptances and other prime paper, heretofore pegged at 3 per cent, and the 2⅜ per cent rate that has been general for Treasury bills.

The reduction in the central bank discount rate paves the way to a lowering of the rates charged by the commercial banks to their trade and industrial customers. Meantime, the general level of open market money rates, including bank deposit rates, has already moved down by about ¼ of 1 per cent, with the rate for prime commercial bills falling more sharply, following abandonment of the pegged rate and adoption by the authorities of the policy of permitting the

rate to fluctuate freely. Both industry and the Government will be able to obtain credit more cheaply, with a narrowing of the unnatural rate differential between the two classes of paper.

While the effective rate the market must pay at the Bank of England remains unchanged at 3½ per cent, as already stated, it will now be possible to borrow at that rate on approved commercial bills instead of only on Treasury bills.

All this doubtless appears highly technical to the American reader. What is significant is the move towards more normal and flexible relationships in the money market, and placing the discount rate in a position to regain its traditional role in influencing credit conditions.

Impact on Security Prices

Still a third feature connected with the Bank of England rate reduction was the strong response recorded in the British security markets. Government bonds gained 2 points or more, part of which was later given up.

Share prices moved up sympathetically, reflecting both the decline in yields of gilt-edged and the psychological lift of the lower Bank rate.

Most immediately, the Government stands to benefit, in that the funding of £989 million of national debt scheduled for redemption in November of this year and March 1954 will be made easier and less costly.

Another advantage to the Government is that the coming steel share marketing – to be carried out in connection with de-nationalization of the steel industry – will be facilitated. This has looked like a formidable operation at best. With the rise in gilt-edge securities being followed by leading industrial shares, the steel shares to be sold by the Iron and Steel Realisation Agency should find a readier market and bring a better price.

Looking further ahead, the improvement in the security markets may well provide a stimulus to the economy at large. Rising security markets tend to generate optimism and to encourage business concerns to invest more freely and expand their activities. Whether this kind of development would be desirable in Britain under the circumstances is questionable. Already the country is operating at full employment and some concern has been expressed over the proportion of production that has been going into the domestic economy rather than into export.

The Broader Significance

Over and above these considerations, the broader significance of the new rate changes lies in the further evidence it affords of a generally lower trend of world interest rates. This in turn reflects the dying down of the inflationary fires started by World War II and rekindled by the outbreak of the Korean war and the launching of the vast programs of rearmament. Though there is some fear that the embers might still flare-up, central banks generally are apprehensive of over-staying the need for restraining policies.

Britain was the fourth European country to lower its Bank rate this year. Austria cut its rate by ½ per cent in March. Holland followed with a cut of ½ per cent in April, and then the German rate was reduced by the same amount in June.

Now that Britain, France, and Denmark have joined this movement, the general level of European Bank rates has fallen definitely below the maximum reached after Korea, 1950-53:

Central Bank Discount Rates of Selected Countries

	Maximum 1950-53	Present Rate
Austria	6 %	5 %
Belgium	3.75	3
Canada	2	2
Denmark	5	4.5
Finland	7.75	5.75
France	4	3.5
Germany	6	3.5
India	3.5	3.5
Italy	4	4
Japan	5.84	5.84
Netherlands	4	2.5
Norway	2.5	2.5
Portugal	2.5	2.5
Spain	4	4
Sweden	3	3
Switzerland	1.5	1.5
Turkey	4	3
Union of South Africa	4	4
United Kingdom	4	3.5
United States	2	2

In contrast with the cheaper money trend in Europe, American rates have, until recently, been hardening. The only important instance of an increase in central bank discount rates anywhere over the past year has been in the U.S., where the Federal Reserve Bank of New York discount rate was raised by ¼ in January, with the real squeeze in the money market coming in May-June. Since then the Federal Reserve has been adding to bank reserves through open market operations and by lowering member bank reserve requirements, though the discount rate remains unchanged at the low 2 per cent level.

International Finance

Problems of international monetary reconstruction and trade development became a focal point of attention again last month as finance ministers and central bankers from more than fifty countries gathered in Washington for the

annual joint meetings of the World Bank and International Monetary Fund. While the meetings are too large for decision-making, they provide a useful forum for exchanges of view, consultations on problems, and official statements of Bank and Fund operations and policies.

President Eugene R. Black reported for the World Bank that loans were made to nine countries for a total of $179 million in the year ended June 30, 1953, running the total for seven years of operation up to $1.6 billion in twenty-nine countries. All loans this past year were granted to so-called "underdeveloped" countries for the purposes mainly of developing electric power capacity, agriculture, mineral resources, transportation facilities, and industry. Mr. Black indicated that studies and negotiations intended to clear the way for further lending have been going forward on an unusually wide range of projects. The Bank replenished its loan resources by selling $75 million additional bonds on September 29.

In the course of his annual address Mr. Black reviewed the many and varied impediments to economic progress but took a hopeful view of the future and of the possibilities for an increased flow of private investments to the benefit of all:

> . . . international investment will play an increasingly important part in the world-wide effort to encourage trade and raise production. Helped by the improvements that have already taken place in the world economy, and by those that could follow from the policies that are being advocated, I believe that private capital would make a large contribution to this investment.

One of the highlights of the meetings was an informal panel discussion, sponsored by the World Bank, on "Private International Investment in Underdeveloped Countries". Participated in by capital-importing and capital-exporting countries alike, it focussed attention on the conditions required to attract an inflow of private capital into the so-called "underdeveloped" countries: political stability; availability of labor, material resources, local credit supplies, and markets; reasonable taxes and labor laws; possibilities of profit greater than those available within capital-exporting nations; and the existence of a welcome attitude toward foreigners who can help develop a country. As Sir Jeremy Raisman brought out in opening the discussion, the very act of sending capital abroad involves a number of unknown elements and risks: expropriation, currency depreciation, and obstacles governments put in the way of profit remittances and capital withdrawals.

Private versus Public Investments

The usefulness of private international investments was stressed by Secretary of the Treasury Humphrey in a talk on September 15 before an advisory group which Senator Capehart, Chairman of the Senate Banking and Currency Committee, has organized to advise his committee on international trade policies. After pointing out that U. S. private investments abroad in the past few years have been more than four times the combined net loan disbursements of the World Bank and Export-Import Bank, the Secretary went on to say:

> Since the end of the war, many countries abroad have been looking to the United States for assistance in financing their economic development. In many instances foreign countries have preferred to obtain their assistance from governmental sources. This raises the very serious question of to what extent this practice should be followed in the future and how it can best be provided, to whatever extent it seems best to carry it on.
>
> Some countries have taken only limited steps to provide the conditions under which private investment will voluntarily move abroad on the basis of normal economic considerations. More attention must be paid abroad to making investment attractive to foreign capital. The countries which have made the greatest strides in their development over the years are the countries which have provided the conditions under which private capital was most willing to invest.
>
> The United States and Canada are two of the most conspicuous examples of countries which have in the last century moved from the state of underdeveloped countries to strong industrial countries in a position to export capital. But I remind you that our development and Canadian development was on the basis of private investment voluntarily made. Countries will be better off if their capital requirement can be met by securing private investment, which brings with it not only money but technical know-how, established trade connections, and business experience.

At the same time the Secretary questioned the Government's right and financial ability "to use taxpayers' money to finance investments abroad on a large scale in the development of competitive enterprise":

> Our scale of taxation is already too high and to maintain a sound and honest dollar we must bring our own expenditures and revenues into balance. We must continue to examine most carefully every proposal to spend money, whether it is a proposal for spending at home or abroad. The maintenance of our credit and of a sound dollar is most important for foreign countries as well as it is for us here at home. Prosperity in the United States is essential for prosperity in the rest of the world, and it is not only our duty but it is for the best interests of everyone concerned that we keep that fact always uppermost in our minds.

The Monetary Fund

The International Monetary Fund, the second of the global financial institutions set up at the close of the war, was intended to provide a huge

pool of all kinds of moneys on which nations could draw as needed to maintain convertibility for their own currencies. The machinery has never worked and generalized convertibility has never been achieved. The frustrations of the Fund, discussed in these pages a year ago, stem out of the continued reign of obstructions to currency convertibility which in turn reflect the slowness of nations to come to grips with inflationary domestic policies and to adjust their currency values to levels that would promote flow of trade. Early in its career, in 1947-48, nations drew heavily upon the original pool of U.S. dollars until the Fund tightened its standards and demanded a prospect of repayment before advancing funds. With growing supplies of dollars in the world markets the Fund has procured repayment of some of the earlier advances as the following table shows:

International Monetary Fund Transactions in U.S. Dollars
(In Millions of Dollars)

Year ended April 30:	Dollars taken	Dollars repaid	Dollar holdings	Gold holdings
1947*	$ 56.0	$ —	$2,004.9	$1,344.3
1948†	544.0	—	1,458.3	1,362.6
1949	108.0	—	1,340.4	1,436.2
1950	51.8	14.7	1,299.4	1,459.5
1951	—	18.2	1,313.3	1,495.0
1952	46.3	20.7	1,283.0	1,531.6
1953	66.1	125.5	1,338.1	1,692.6

*Four months ended June 30, 1947. †Ten months ended April 30, 1948.

Thus the Fund's holdings of gold and U.S. dollars have been restored to $3 billion. The Fund has invited countries to seek its aid when they are ready to restore free convertibility of their currencies. So far, for various reasons, there have been no takers.

The main accomplishment of the Fund has been to draw attention to the sound policies of government finance prerequisite to restoring to people abroad freedom to spend their money where they choose. Along this line, Mr. Ivar Rooth, Managing Director of the Fund, had the following to say at the recent meeting:

> . . . One of the important aspects of convertibility is that it compels countries to face squarely the question whether they are prepared to take the measures that will create internal financial stability.
>
> Unless a country's financial policies are sound, the excessive supply of its money at home and abroad becomes the means by which its reserves of gold and dollars are drained away. A budget in balance or in surplus helps establish convertibility. Restraint in the expansion of credit facilitates convertibility. A balanced investment program based on available resources contributes to convertibility. A wage level reflecting productivity is essential for convertibility. And, of course, countries must also pursue proper exchange, trade, and payments policies.
>
> I believe that the industrial countries are now in a better position to solve their payments problems than at any time in recent years. Reconstruction is near completion. Production is at a level which should enable these countries to pay their way. Undoubtedly, the economies of many countries are strained to provide large resources for defense. And there is still a tendency toward over-investment in some countries. Nevertheless, the present inflation in certain industrial countries is generally mild, in contrast to the substantial inflation of the immediate postwar years. There can be no doubt that this inflation can be eradicated by proper fiscal and monetary policy.
>
> In the underdeveloped countries, experience has shown that inflation does not necessarily bring development, but that it does lead to social and economic difficulties. The only way to secure development with stability is to limit investment to the real resources available from home savings and from foreign investment and aid. Unless and until the underdeveloped countries can secure a tolerable level of investment, based on real resources from home and abroad, they will be under constant pressure to try to meet their needs by creating credit. And persistent inflation in the underdeveloped countries is just as destructive of international balance as inflation in the industrial countries.

Gold and dollar resources of nations abroad, recently accumulating at a rate exceeding $2 billion a year, now equal the U.S. gold stock of $22 billion. A number of individual countries should be nearing a position, if they have not already reached it, where convertibility should be feasible. The tendency has been for nations to wait for somebody else to move first. Mr. Rooth, referring to this tendency, pointed out that it may condemn the world to "inconvertibility, discriminations, and restrictions for a very long time."

Gradual Approach to Convertibility

Note was taken at the meetings of the slow but cumulatively significant steps toward breaking the fetters of foreign exchange and trade controls; the easier administration of such controls in some countries; the loosening of restrictions on private foreign exchange dealings and holdings; and the reopening of international commodity markets in the United Kingdom. These easements, which some had feared would place undue strain on official currency reserves, often have had quite the opposite effect of stimulating confidence in the local currency.

There were informal discussions of British schemes for speeding convertibility of the pound sterling. These plans are understood to hinge among other things on a further accumulation of gold and dollar reserves of the United Kingdom (now at a $2½ billion level), availability of large standby credit facilities from the International Monetary Fund or some other agency, and a further liberalization of American import policy. Spokesmen from the British Commonwealth have hinted strongly that, for purposes of generating more gold and dollars in support of a broad convertibility effort, the United States should inflate the price of gold and its own econ-

omy. It was made clear at the meetings that American policy remains firmly set against this last proposal which has been brought up time and again in the postwar years.

Unlike gold policy, American foreign trade and aid programs are under review by a special commission headed by Clarence B. Randall, chairman of the board of the Inland Steel Company. This commission, made up of distinguished citizens in and out of Congress, launched its work September 22. A somewhat parallel inquiry is being undertaken by Senator Homer E. Capehart of Indiana, Chairman of the Senate Banking and Currency Committee. No one can predict with any assurance what precise recommendations may emerge from these studies. But passage of Customs Simplification legislation, effective September 8, and the year's extension of the Reciprocal Trade Agreements Act reflect a liberal approach on the part of the Administration and Congress toward imports.

One topic of uniform interest to foreign officials attending the meetings was the future course of American business. No one could give any ironbound guarantees on this point since fluctuations are inherent in any country where people are free to change their minds as to what and when they want to buy. Fears were expressed that the United States might be due for a depression involving a shrinkage in imports, a raising of tariff barriers, and a drain on foreign currency reserves — on the pattern of the nineteen-thirties. It can only be trusted that statesmen here and abroad, in the eventuality of a sharp downturn, will be wise enough to see — from the experience of twenty years ago — that suffocation of trade is a method of prolonging, rather than curing, trade depression.

Frontiers of Industry

One of the many signs of this country's continuing economic progress is the rapid emergence in recent years of a group of new industries making laboratory and control equipment. Development of such apparatus received great impetus during World War II in connection with the country's intensified program of scientific research for creating advanced military weapons. At the same time, the new equipment found a place in industry to aid in turning out more and better products despite wartime shortages of skilled workers.

After the war further stimulus was given to business applications of such devices by their ability to help offset rising costs. A series of radically new types of instruments, unheard of only a short while before, became available to the markets.

The notable expansion taking place in these lines is, of course, only another step in the long-term evolution of industry in its ceaseless search for improved methods and lowered expenses. Such expansion serves as another refutation of the theory propounded in the '30s that the country had reached "economic maturity" and no longer possessed room for growth.

Laboratory and control equipment is being made in a great variety of different types, some of which are unbelievably complex. The various instruments may be mechanical, hydraulic, pneumatic, thermostatic, chemical, magnetic, electronic, or a combination of several. They have quickly found applications in the basic industries — steel, machinery, oil refining, chemicals, medicines, textiles, and, of course, aircraft, radio, television, and the almost uncharted field of atomic energy.

They may be used to measure or record the changing physical characteristics of solids, liquids, or gases. They may test manufactured products at selected stages for size, composition, color, or purity. In addition, the instrument readings may be fed back for the automatic control of the processing machinery itself. Some control devices for correcting automatically any deviation from standard have proved far more accurate and prompt than any possible control by human hands.

A particular instrument may be an electronic device to control an atomic reactor pile, to inspect tin plate being rolled in a steel mill, to detect impurities in peanut packing, to X-ray canned beer in a brewery — or it may be some entirely different, non-electronic type. It may direct a massive machine tool through its intricate cycle, analyze continuously the chemical composition of hot gas, or solve complex mathematical equations in a flash. Also it may count out 100 pills into a bottle, time the right exposure for a photographic print, cause an elevator to stop level with the floor, check merchandise inventories, monitor the operations of a remote plant, or locate a school of fish in the ocean.

Some recently completed plants in this country are so fully equipped with automatic controls that, properly set up and fed, they practically run themselves.

When the oil industry, in its efforts to meet the nation's unprecedented demand for petroleum products last year, drilled a record 44,388 new wells, electronic equipment for seismographic analysis helped in locating oil formations. In unproven areas especially, the wells located on this

scientific basis were several times as successful in bringing in oil as the "wildcats" drilled without such guidance.

A promising new development is the transistor, a tiny electronic device made of the rare metal germanium or certain other elements. It does about the same work as a vacuum tube in many applications but takes up much less space, uses much less current, generates almost no heat, and lasts almost indefinitely. Transistors are making possible electronic equipment of smaller, lighter and more durable design. In the laboratories the quest is on to improve the performance and widen the horizons of use.

A few days ago the U.S. Navy and National Bureau of Standards jointly unveiled a project in cooperation with private manufacturers for the automatic mass production of resistors and condensers needed in radio and other electronic instruments. The units, in the form of miniature ceramic wafers, have circuits printed in metallic paint in place of conventional wires for conducting the current when they are stacked together. Such standardization of parts for assembly automatically is expected to bring about substantial savings in the time, materials, and skilled labor heretofore required for manufacturing, hand assembling, wiring, soldering connections, and testing at every stage of the process.

New Science of "Instrumentation"

The instruments have been refined in scope and accuracy far beyond comparison with the best available a few years ago. Temperatures may be closely controlled at ranges up to 7,000° F. and down to the approach of absolute zero at minus 459.6° F. Electric current may be measured in millionths of a millionth of an ampere. Some laboratory instruments will measure pressures up to 50,000 pounds per square inch, while others will measure the minute pressure in an almost complete vacuum expressed in millimicrons (billionths of a meter) of mercury. "Instrumentation" has taken its place as an important new science, with its technical trade journals and professional membership association.

Supplying these new tools to industry has itself become a sizeable industry — or group of highly specialized industries. During the past several years many new companies have been organized, most of them family or closely-held corporations that do not release financial information. A limited number, however, have begun publication of regular statements or filed registration statements with the Securities & Exchange Commission as a result of the widening distribution of their stock ownership or their need to attract additional capital — equity or borrowed. A group of twenty-five such concerns shows combined sales in 1952 amounting to $277 million, a gain of 22 per cent over 1951. This contrasts with a gain of only 3 per cent for the manufacturing industries as a whole.

The marked strides made by the younger companies does not of course mean that the large and old-established companies interested in the same fields have been idle. Leading organizations which also have been spending vast sums for research and development work comprise a long list including numerous well-known companies, each having total sales exceeding $100 million annually, such as Admiral, Allis-Chalmers, American Telephone, Bendix Aviation, Burroughs, General Electric, International Business Machines, International Telephone, Minneapolis - Honeywell, Motorola, National Cash Register, Philco, Radio Corporation, Raytheon, Remington-Rand, Sperry, Sylvania, Westinghouse Electric, and Zenith.

Better Goods at Lower Costs

All the people and organizations making up these new industries, whether divisions of giant enterprises or humble independents, whether employed in the manufacture of instruments or in their practical application, have one common aim — to aid industry in producing better goods at lower costs.

Constant research for new and better techniques and unceasing investment of new capital in the industries promise still further gains in the years to come through making work lighter, less tiring, and shortening the hours, yet lifting productivity. The new instruments, developed first for research purposes and then finding applications in industry for tireless automatic controls, are now relieving the factory worker's mind and hands of many routine tasks in the same way that the continual additions of motive power and machinery have taken over the burden from his back and muscles. At the same time, the demand for higher levels of skills and engineering talent is increased.

We are all benefitting today from laboratory developments for which yesterday no use was known. Research and investment are the tried and proven methods to raise the living standards of the people generally — whether they be engaged in manufacturing, farming, transportation, or elsewhere, and whether they be wage earners, executives, shareholders, or annuitants. By this process the outer frontiers of fundamental science rapidly become the new frontiers of industry.